

Earnings inequality and in-work-poverty

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REC-WP 07/2009



Working Papers on the Reconciliation of Work and Welfare in Europe

Earnings inequality and in-work-poverty

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Rodolfo Gutiérrez Palacios, Ana Marta Guillén Rodríguez and Ramón Peña-Casas:

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Abstract

Earnings are one of the most relevant dimensions of job quality. They are the main reward within the employment relation, the one most valued by workers and the most multi-faceted instrument for achieving other goals. Very frequently, it is also closely associated with other objective and subjective dimensions of employment quality. Still, sociological and politics research only rarely consider the monetary components of employment quality.

In the last two decades, different factors stemming from the process of globalization, the evolution of the economy, changes in the labour market and social protection institutions and policies have led to changes in the level and patterns of earnings and income inequality. This contribution does not intend to draw a detailed picture of the state of that research; it rather aims to provide a quick glance into the situation and the most recent long or medium-term wage trends in a comparative international and European perspective. It is divided into 6 sections. The first deals with our level of knowledge about the impact of economic globalization on earnings inequalities. Sections 2 and 3 are devoted to the dynamics and present situation of the incidence of low paid work and in-work poverty respectively. Section 4 reflects on the different social, labour market and tax policies that may potentially rescue people from low pay and in-work poverty. Section 5 evaluates existing data and indicators. Finally, section 6 includes some tentative proposals for future research.

Keywords

Earnings inequality in the European Union, in-work poverty, job quality labour market policies, social protection policies.

Introduction

Earnings are one of the most relevant dimensions of job quality. They are the main reward within the employment relation, the one most valued by workers and the most multi-faceted instrument for achieving other goals. Very frequently, it is also closely associated with other objective and subjective dimensions of employment quality. Still, sociological and politics research only rarely considers the monetary components of employment quality. This is why it would be most advisable to pay close attention to wages and wage inequalities as a central dimension of the tension between the quantity and quality of employment, as well as to the way this dimension relates to the rest of the relevant ones in terms of quantity as well as quality.

Research on wages is a huge field both in terms of focuses and results. This contribution does not intend to draw a detailed picture of the state of that research; it rather aims to provide a quick glance into the situation and the most recent long or medium term wage trends in a comparative international and European perspective. Two aspects have received most of the attention: wage inequalities, on the one hand, as the dimension which best expresses the tension between quantity and quality; and, on the other hand, in-work poverty for being the best indicator of the effects of wage rewards on the quality of life, as households rather than individuals are the units that receive and manage wage income as well as other sources of income. The value of this indicator is proved by the relevance it has gained over the last few years in European politics on social inclusion.

In the last two decades, different factors stemming from the process of globalization, the evolution of the economy, changes in the labour market and social protection institutions and policies have led to changes in the level and patterns of earnings and income inequality. This paper is divided into 6 sections. The first deals with our level of knowledge about the impact of economic globalization on earnings inequalities. Sections 2 and 3 are devoted to the dynamics and present situation of the incidence of low paid work and in work poverty respectively. Section 4 reflects on the different social, labour market and tax policies that may potentially rescue people from low pay and in work poverty. Section 5 evaluates existing data and indicators. Finally, section 6 includes some tentative proposals for future research.

Globalization of labour markets and earnings

Much of the attention on the drivers of earnings inequality has focused on technological and institutional factors. But, as a result of the intense globalization of the economy during last two decades, global integration of labour markets has become the most likely factor influencing earnings and earnings distribution (Freeman 2009; International Monetary Fund (IMF) 2007, chapter 4, OECD 2007, chapter 3). Some forces have driven this global integration. Among them is the increasing involvement in open market economies of large amounts of labour forces in specific regions of the world (China and India, mainly). Also, the location of production has become much more responsive to relative labour costs across

countries, as the development of technology, combined with the progressive removal of restrictions on cross-border trade and capital flows, have facilitated that production processes be located farther from target markets for a growing universe of goods and services. Finally, since the early '90s, there has also been an expansion of the global work force, caused by increasing flows of migrants, from and to all world regions and through both legal and informal routes.

Within such context and adding to it raising working age populations, the effective pool of global labour supply (as the weigh of each country's supply by its export-to GDP ratio) quadrupled between 1980 and 2005, with most of the increase taking place after 1990 (IMF 2007, chapter 5). Most of the total increase in the global labour supply consisted of less-educated workers (defined as those without higher education). However, the relative supply of workers with higher education increased by around 50 percent over the last 25 years. This expansion is expected to continue in the coming decades. The UN foresees a 40 percent rise in the world's working-age population by 2050. Keeping the growth of trade openness, especially in services, tentative projections suggest that the effective global labour supply could more than double again by 2050.

The expected pressure on wages of this intense growth of global labour has not led to a deterioration of real earnings compensation of workers in advanced economies. A decline in the share of national income received by labour has been ascertained but also a moderate raise in real compensation of workers. It is supposed that the potential negative effect on wages of an increasing labour supply has been offset both by other gains in productivity of international trade and by rules and policies affecting the wage formation in advanced countries.

Over the last twenty-five years (1980 to 2005), there has been a decline in the income labour share (European Commission 2007, chapter 5; IMF 2007, chapter 5, much more pronounced in Europe and Japan, about 10 percentage points, than in Anglo-Saxon countries, including the United States, about 3–4 percentage points, (Figure 1). This means a reversion of the rising tendency of the income labour share registered in most of the advanced economies during the sixties and seventies, especially intense in Europe and Japan. The drop is sharper for the overall labour share than for the employee share, as the former also accounts for a fall in weight and income of other categories of workers (self-employed, family workers and employers, mainly).

Most of the decline in the labour share can be attributed to the fall in unskilled sectors, which was more pronounced in Europe and Japan than in the Anglo Saxon countries. This decline is caused by a combination of factors: both the reduction in the labour share within-sectors and the shift of output from unskilled toward skilled sectors. On the other hand, the income share of labour in skilled sectors has been on the rise, especially in Anglo-Saxon countries where it has increased by about 5 percentage points. It must be noted that these results are referred to income shares of workers in skilled and unskilled sectors, not to income shares of skilled and unskilled workers themselves.¹

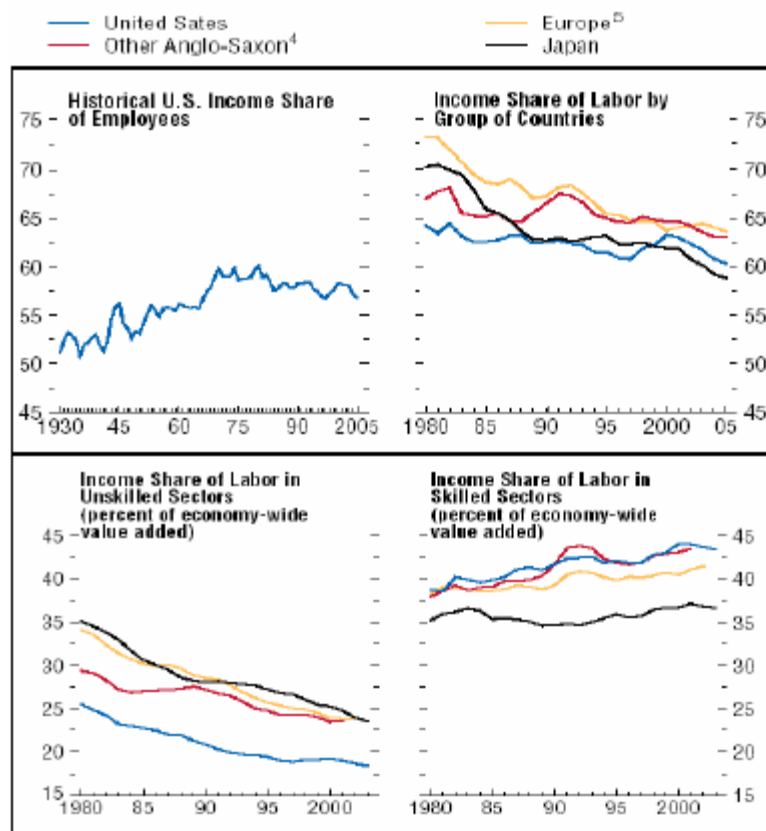


Figure 1: Labour income share in advanced economies (1980-2004) (as a percentage of GDP)

(4) *Anglo-Saxon economies include Australia, Canada, and the United Kingdom. Australia is excluded from the analysis by skill level due to lack of data.*

(5) *Europe includes Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, and Sweden. Ireland, the Netherlands, and Spain are excluded from the analysis by skill level due to lack of data.*

Source: International Monetary Fund calculations on different sources (2007, pp 168-169).

Despite the fall in the overall labour share, both employment and real labour compensation per worker have increased in all advanced economies since 1980, with growth accelerating, both labour market outcomes, since the mid '90s (Figure 2); while it is observed a stronger weight on employment in the Anglo-Saxon countries and on real compensation per worker in Europe. A general trend towards improvement of real work compensation is also observed in emergent economies during same period. Relative manufacturing wages in emerging Asia are generally increasing, catching-up to those in advanced economies, these patterns being more intense in the newly Asian industrializing economies, such as Korea, Singapore, Hong Kong and Taiwan and showing a slower pace of convergence in China and other Asian economies. In contrast, Latin American economies have not experienced much convergence.

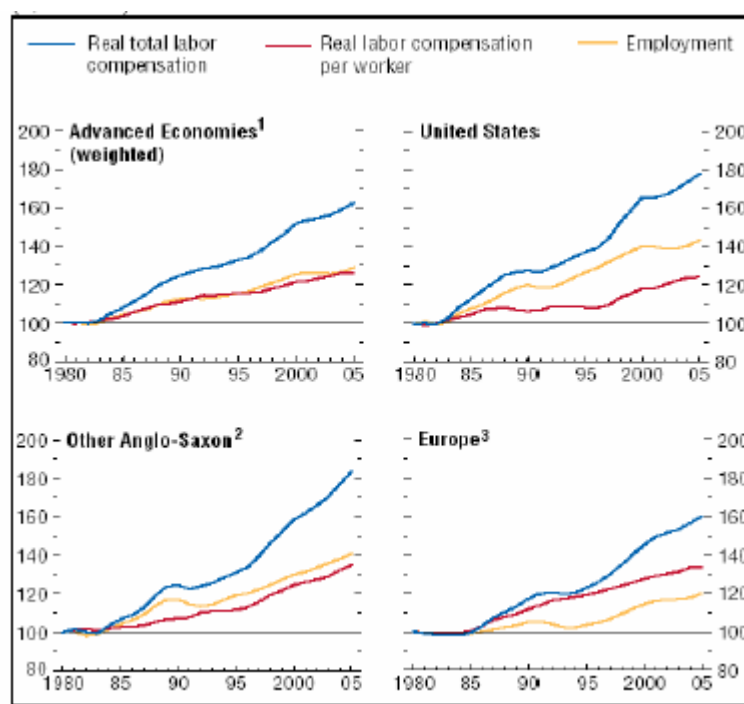


Figure 2: Labour compensation and employment in advanced economies (1980-2005) (1980=100)

(1) *Advanced economies include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Norway, Portugal, Spain, Sweden, the United Kingdom, and the United States; weighted using series on GDP in U.S. dollars from the World Economic Outlook database.*

(2) *Other Anglo-Saxon economies include Australia, Canada, and the United Kingdom.*

(3) *Europe includes Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, and Sweden.*

Source: International Monetary Fund (2007, p. 170) calculations on different sources.

In any case, the evolution of employment as well as of labour compensation is very different for the skilled as opposed to the unskilled sector and also depending on which area of the advanced economies is being considered (Figure 3). The overall labour compensation growth in the unskilled sectors has been very weak, not more than 15% in just over 20 years. But the pattern by areas of this growth and the way it relates with employment growth in these sectors differs strongly in the USA, and in Europe and Japan. Employment growth in the unskilled sectors has remained rather stable in the USA reaching a total of 20% over the last decades, thus modifying from 100 to 125 the relation between employment in the skilled and unskilled sectors; in the same period, increases in real compensation per worker have been meagre, no more than a 5% and limited to very recent years; and the earnings gap between skilled and unskilled sectors has widened by 25 percent. In Europe, and in a similar way in Japan, employment in unskilled sectors actually contracted by a cumulative

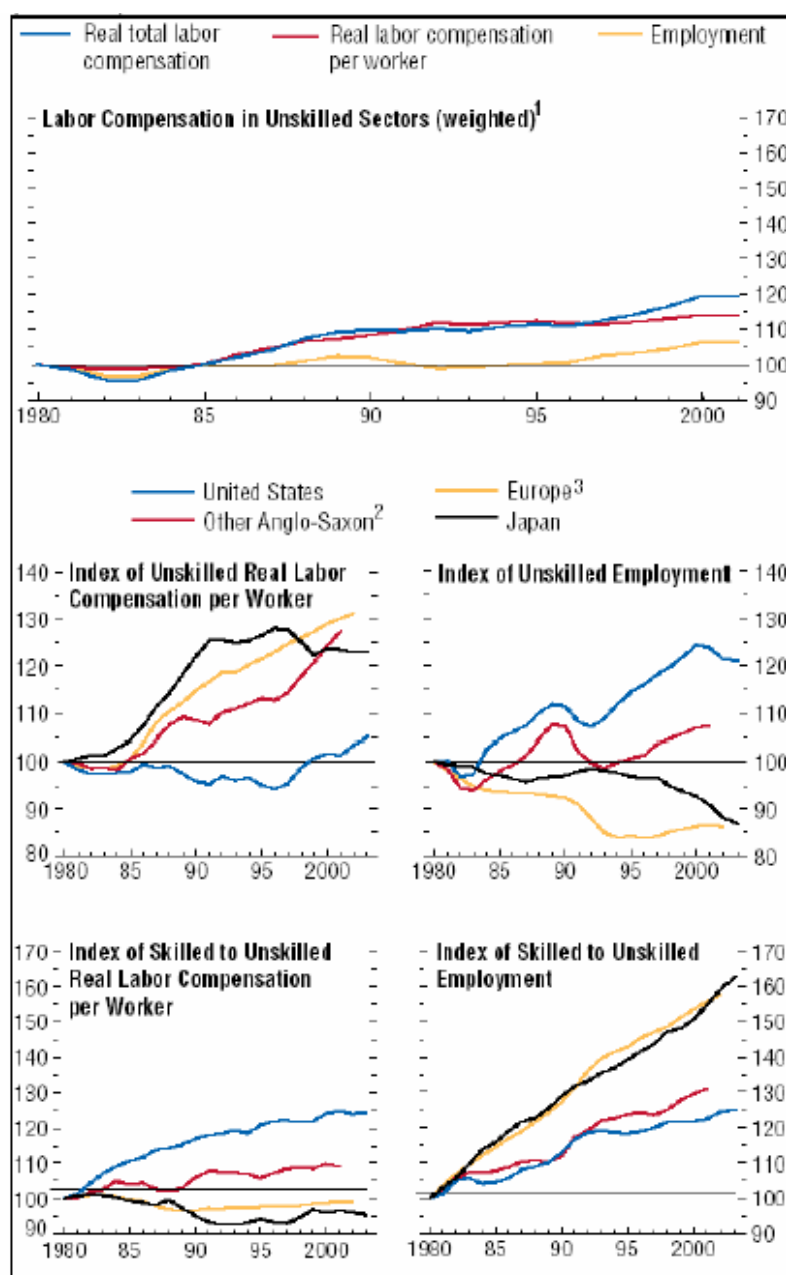


Figure 3: Labour compensation and employment in skilled and non skilled sectors (1980=100)

(1) For analysis by skill level, advanced economies include Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Norway, Portugal, Sweden, the United Kingdom, and the United States; weighted using series on GDP in U.S. dollars from the World Economic Outlook database.

(2) For analysis by skill level, Anglo-Saxon economies include Canada and the United Kingdom.

(3) For analysis by skill level, Europe includes Austria, Belgium, Denmark, Finland, France, Germany, Italy, Norway, Portugal, and Sweden.

Source: International Monetary Fund (2007, p. 171) calculations on different sources.

15 percent and has led the index skilled to unskilled employment to about 160; although real compensation per worker in unskilled sectors grew broadly in line with that in skilled sectors, at about a cumulative 30 percent; and the gap index of labour compensation between both sectors showed a steady decline pattern.

The different employment structures, mainly in the services sector, as established by various reports and in European Commission (2004, chapter 3), account for such different results between Europe and the US in employment and labour compensation. One can clearly note the difference in employment between the EU and the US (also within the EU), divided more or less equally among both ends of the wage distribution, at the highest and the lowest wages.

These studies² show that differences in employment structures are not due to comparatively more rigid salary structures or more rigid wage setting institutions, as is commonly believed: the relative salary structures are quite similar in all countries and do not seem to prove an important factor to determine employment structures. These differences are mainly structural and due to important differences in other dimensions of labour markets; in demand for jobs, with much higher consumption patterns in the US causing the final demand to rise, as well as to changing labour supply, especially by women and ageing workers, and to demographic changes and changes in the composition and structure of households.

Earnings inequalities and low-paid work

Both OECD (2001, chapter 2; 2004, chapter 4; 2006, chapters 2 and 5) and European Commission (2003, chapter 2; 2004, chapter 4; 2005, chapter 4), in their annual reports on employment, provide a regular description of main trends in the evolution of earnings and earnings inequality in developed and European countries. These descriptions inform of a recent trend of increasing earning inequalities and on the incidence of low-paid work (this one less intense), but this trend is not clearly related to improvements of labour market performance. Following one of the most recent OECD reports (2006, chapters 2 and 5), since the mid '90s gross earnings inequality referred to full time employed population and measured by the ratio of the 9th 1st deciles full year earnings- has increased on average in OECD countries. Earnings inequality had already showed a tendency to increase in the previous decade, but rose at an accelerated path in the most recent period (Figure 4). Although in most countries inequality has risen very slightly, drops have been observed in a few countries, very significantly in Spain and Ireland and only slightly in Japan. There have been significant increases in countries with a high (US, Hungary and Poland) as well as a low (Czech Republic, Switzerland and Netherlands) level of earnings inequality.

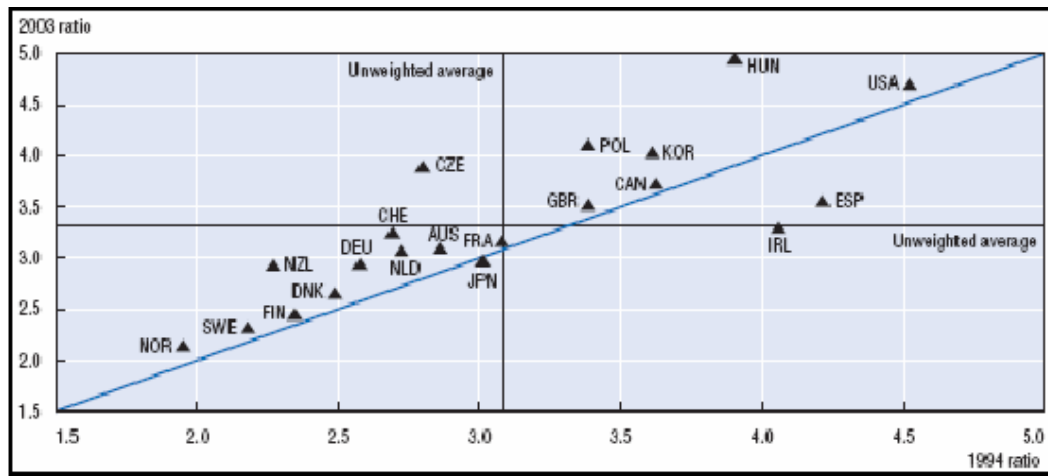


Figure 4. Gross earnings inequality¹ in OECD countries² (1994 and 2003)

(1) *As measured by the ratio of the 9th to 1st decile earnings, full-year, full-time workers.*

(2) *1994 and 1999 for the Netherlands, 1994 and 2000 for Hungary and Ireland, 1994 and 2002 for France, Germany, Korea and Poland, 1995 and 2002 for Spain, 1996 and 2003 for the Czech Republic and Denmark, 1997 and 2002 for Norway, 1997 and 2003 for Canada.*

Source: OECD, Employment Outlook 2006.

This path occurred in countries where labour market performance improved considerably as well as in countries where it deteriorated, although reductions in earnings inequality were also observed in some countries with good recent labour market results. However, it seems quite difficult to identify a general relationship between trends in earnings inequality and labour market performance. The overall decrease of unemployment from the mid-nineties onwards has clearly brought about a growing earnings inequality if only workers' wages are considered, except in the cases of Spain and Ireland where employment grew considerably while earnings inequality dropped, as we saw before. But if we consider all households no matter their labour participation, it looks like inequality drops when unemployment drops too, as would occur in the countries that appear shaded in Table 1. This could mean that employment earnings can compensate the unequal distribution of wage income among the households, as the lower income ones will have benefited most from the improvement of employment.

Inequality	Period before 1993-94			Period after 1993-94		
	Unemployment rate			Unemployment rate		
	Decline	Almost constant	Increase	Decline	Almost constant	Increase
	Decline		Spain	Belgium Denmark Finland Ireland Italy	Netherl. Spain United Kingdom	Austria
Almost constant or unclear	Belgium Netherlands		Sweden	France Norway Sweden United States	Portugal	Germany Greece
Increase	Canada Denmark Ireland Portugal United Kingdom United States	Japan	Australia Finland France Germany Greece Italy Norway Switzerland	Canada	Switzerland	Czech Republic Japan

Table 1: Trends of unemployment and labour earnings inequality across all households

Source: OECD, *Employment Outlook 2006*.

Atkinson (2007) has separately examined tendencies on the top and the bottom of the distribution earnings for 12 OECD countries (including Anglo-Saxon countries, Continental Europe, Eastern Europe and the Nordic countries). This analysis does not support the conclusion that there has been a “general” increase in earnings dispersion since 1980. The top and the bottom of the distribution have been differently affected and there are differences across OECD countries. On the lower part of the distribution, the bottom decile has fallen in five countries more than 10 per cent since 1980, but in two cases (the United States and Italy), there was a subsequent recovery, and also in the two Eastern Europe’s countries where other forces were at work. Much clearer is the rise in the top decile, and the fanning-out of the upper part of the distribution, with the top decile increasing more than the upper quartile, and with the top decile rising by 10 per cent or more since 1980 in seven countries (United Kingdom, the United States, Australia, New Zealand, Germany, Italy and Portugal).

There is wide agreement on explaining the causes of widening earnings dispersion in most OECD countries. This is generally explained by the steady increase in relative demand for skilled labour due to two main factors. The first one consists of the impact of globalization, with the jobs of unskilled workers being increasingly exposed to international competition. And the second major factor is technological change biased in favour of skilled workers. This conventional explanation is questionable when it is confronted to the mentioned facts, i.e., that increase in inequality has been uneven across countries and greater earnings

dispersion has mostly been occurring at the top of the distribution. Atkinson (2007) argues that two alternative possible explanations of the fanning-out of the upper part may be forwarded. The first one emphasizes a possible shift in behavioural pay norms, from an equilibrium, with a high level of conformity to a “traditional” pay norm (relatively low wage differentials for equally qualified workers), to an equilibrium where a much larger proportion of these workers are paid on the basis of their productivity. This produces a move towards a more spread-out distribution. The pay norms shift is linked to changes in capital markets, pressing employers to attach more weight to short-run profits and less weight to reputation, which is a long-run investment. The second suggested explanation combines the “superstar” theory, focused on the increased concentration of superstar rents resulting from expansion of technology and trade, with hierarchical earning models that point out a potential switch from hierarchical pay to rent-sharing, with people paid like “salesmen” rather than on fixed salary scales.

Another basic indicator, low-paid work, shows a more varied picture (Figure 5). The incidence of low pay has increased in a number of countries, but that occurred in countries typically with low level of low-paid work, some others with medium level, and also with an already high level. By contrast, it decreased significantly from a high level in a group of countries, some of them still remaining in the group of countries where more than 20% of employees are low-paid.



Figure 5: Evolution of the incidence of low-paid work^a in OECD countries since the mid-1990s

(a) Percentage of full-time wage-earners earning less than two thirds of the median wage of full-time wage earners.

(b) 2000 for Hungary, 2001 for Belgium, Finland, France, Greece, Italy, Portugal and Spain, 2002 for Germany and Poland, 2003 for Canada and Denmark, 2004 for the other countries.

(c) 1996 for Denmark and Finland, 1997 for Canada and Sweden, 1994 for the other countries.

Source: OECD Earnings database and OECD calculations based on the European Community Household Panel (ECHP), waves 1 and 8.

Not surprisingly, the incidence of low-paid work is lower in countries where the minimum wage is set at a higher level. In all countries, youth low-pay incidence is at least two times that of the prime-age group. Low-educated workers are also more often low-paid than those with medium and higher education. The over-representation of youth in low-paid jobs need not automatically imply low living standards – many youth are still living with their parents– or poor long-term career prospects, but the association between low-education and low-pay suggests that low-pay traps may be significant.

Research on low-paid work has increased substantially over the last few years. Some of the most relevant contributions in this field have occurred in the context of LOWER (European Low-wage Employment Research Network). This research covers a wide range of subjects, such as low pay and low skills; minimum wages and employment; wage inequality and earnings mobility; intergenerational and intragenerational inequalities; gender, pay, part-time employment and skills; employment structure and quality; immigration and low pay; training and employment behaviour (Marx and Salverda 2005; Lucifora; Bazen and Salverda 2005).

The increase in gross earnings inequality observed in that period may have been more than offset by the redistributive impact resulting from the employment gains achieved during this period, while redistribution through taxes and transfers has declined in many countries. As a result of both tendencies, household inequality at the level of disposable income changed relatively little during the past decade, except in a small group of countries (Fig 6).

On the other hand, relative poverty rates –that is, the proportion of the population with income below 50% of the current median income – have risen marginally since 1994 (Figure 6). Significant increases were seen both in countries where labour market performance improved markedly and average income grew significantly (*e.g.* Ireland), as well as in other countries (Sweden). However, relative poverty remained more or less unchanged in countries where labour market performance improved (*e.g.* in the United Kingdom and the United States). In the latter country, relative poverty rates remain high by OECD standards.

There has been a persistent increase of the proportion of working poor in the total population. On average for the OECD area, the incidence of working poverty has increased more modestly after the mid '90s than during the previous decade, although half of the countries for which data are available have reported increasing proportions of working poor during the last decade.

Low-paid work and working poverty cross-sectional statistics provide a snapshot of earnings inequality problematic at least in two aspects: for one, they include people at very different phases of their life course and, consequently at varied stages of levels of work participation; for another, they may misrepresent real earnings inequality if there is a high mobility in earnings over time, putting together people with transient low-paid or working poverty situations with people with persistent ones.

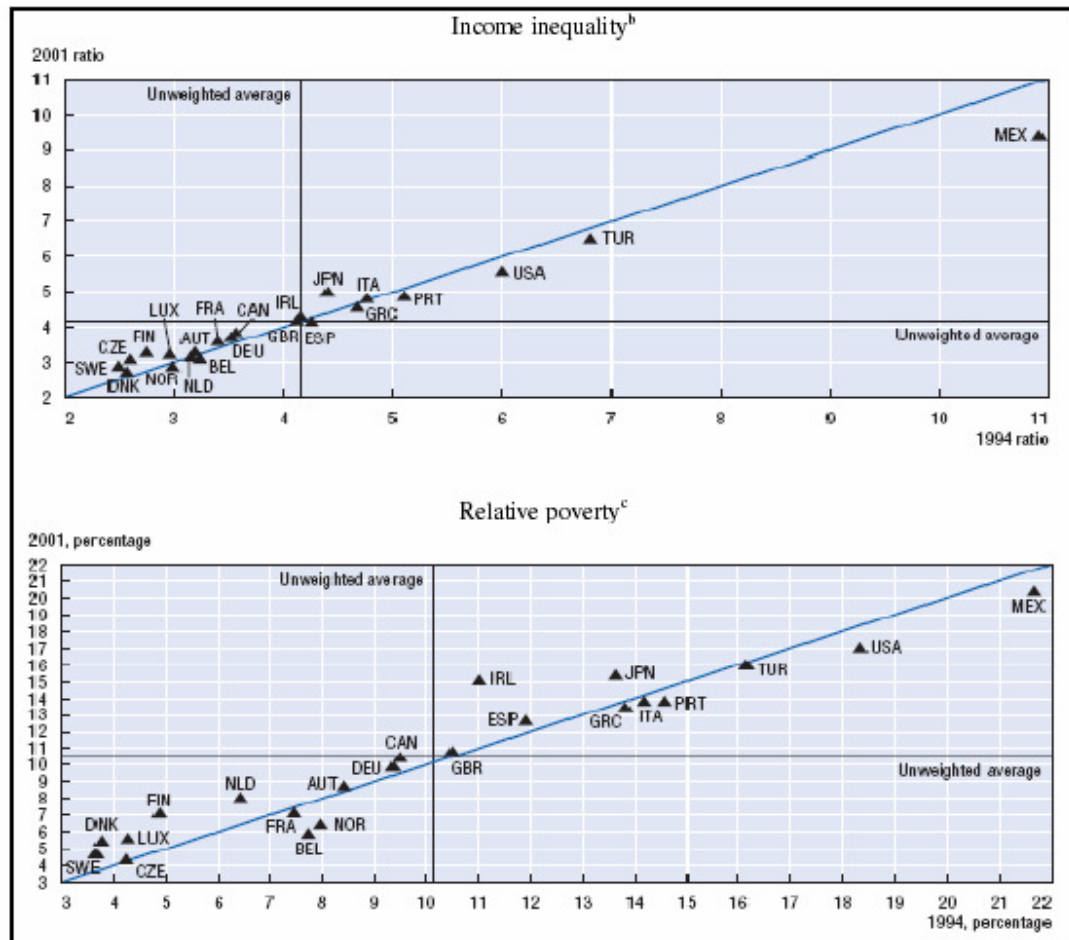


Figure 6: Household income inequality and relative poverty in 1994 and 2001^a

(a) 1994 and 1999 for Austria, 1994 and 2000 for France and Japan, 1994 and 2002 for Mexico and Turkey, 1995 and 2000 for Canada and Norway, 1995 and 2001 for Belgium, Finland, Italy, Portugal and Sweden, 1996 and 2002 for the Czech Republic.

(b) As measured by the ratio of the 9th to 1st decile earnings of equivalised disposable income (i.e. household income, after taxes and transfers, that is adjusted for the number of persons in the household).

(c) Calculated as the proportion of the population with equivalised disposable income below 50% of the current median income.

Source: *Employment Outlook 2006*.

There is solid evidence of the existence of low-pay traps. With an indicator provided by OCDE for a three-year period (1998-2000), mobility prospects of low paid workers across countries shows a tendency to be negatively correlated with low-pay incidence. The same overall picture holds when taking into account periods of non-employment together with periods of low pay, although the differences across countries are more muted. Overall, upward mobility of low-paid workers has tended to improve between the mid-1990s and the late 1990s or the early 2000s –possibly

reflecting the effects of the cycle. In most countries, low pay/no-pay traps weigh more heavily on prime-age workers than on youth, who, not surprisingly, have on average higher upward mobility.

In terms of poverty and working poverty dynamics, some patterns seem quite general. In a majority of above-average-poverty countries, relative poverty tends to be a permanent phenomenon with durations of poverty spells above average and transitory exits from poverty. However, in those countries where poverty can be considered as a transitory phenomenon, exit from poverty is also temporary (with an above-average probability of falling back into poverty). It is striking that a majority of high-poverty countries exhibit relatively high upward income mobility. In contrast, in low-poverty countries, relative poverty is a transitory phenomenon, exit from poverty situations frequently results in permanent non-poverty situations, but those who exit poverty end up with relatively low income, possibly reflecting lower incentives to move up the income ladder in relatively more egalitarian countries.

Working poor in the European Union

For long the issue of working poverty has been left aside in public, policy and academic discourses in Europe. The term “working poor” was sometimes mentioned to characterise the situation in the United States and to put into perspective the performances of American economy in terms of job creations by stigmatising the lower quality of the created jobs (the so-called Mac Donald jobs). It was also used as a synonym of low wage work although both issues are distinct (see below). The implicit belief was that there were no such thing in Europe, and if so only at a marginal level, due to the higher level of social protection(s) in our countries comparing to the rest of the world. Employment was clearly assumed to totally protect individuals from poverty. If this assumption was mainly true during the so-called Golden Years after WWII, the rise of unemployment since the Seventies and the relative failure of policies pretending to eradicate it, the priority given to competitiveness of enterprises as an incentive for higher employment supply, and the constant emphasis put across time on policies increasing flexibilisation, deregulation and casualisation of European labour markets have generated the apparition of a “New Poverty” which affects also workers. These changing patterns of labour market policies were also accompanied by an increased indictment and challenge of ‘too’ generous welfare states in order to ‘make work pay’ which have amplified this trend.

Since the introduction of the European Employment Strategy in 1997 and especially since 2000 when the EU launch the Lisbon Strategy the question of working poverty has become more present in the European debate. The latter has put emphasis on the necessity to consider in a complementary perspective the interactions of economic, employment and social policies (the so-called ‘Lisbon virtuous triangle’).

The (relative) focus at European level on quality of employment and the (relative) objective to fight poverty and social exclusion have contributed to place the working poor in a central position in the interplay between the European

Employment Strategy and the OMC on poverty and social exclusion. The existence of working poor signals that even if employment is still the best way to avoid poverty it is nevertheless not always sufficient. Avoiding poverty is as such an important dimension of quality in-work, the less you can expect from an employment in our societies is that it protects from poverty.

Definition of working poor in EU framework

There are different definitions of the working poor in international academic literature but they all have in common the consideration of not only the work status and intensity of the individual but also the household where this worker lives and its global income to define poverty situation. If work is assessed at individual level poverty is assessed at the level of household.³ Thus, we have to consider not only the income of the individual worker but also the income provided by other members of the household and other sources of income such as own capital and social protection transfers as well as the effect of tax systems.

In 2003 the “sub-group indicators” (SGI) of the Social Protection Committee has defined a European indicator on working poor to be used in the framework of the OMC on social inclusion. It should be mentioned that initially the issue was discussed in the SGI of the Employment Committee as working poor are explicitly mentioned in the Employment Guidelines and that a (vague) objective concerning the reduction of their number is evoked but the task was entrusted to the SPC SGI given that it was related with poverty. Thus, this indicator is also used in the European Employment Strategy. Working poor are defined as individuals which during the previous year were “mainly” at work (at least six months) and are living in a poor household with an income below the “at-risk-of” poverty threshold (60% of median equivalised income).

Concretely the indicator is based on the breakdown of the at-risk-of poverty rate by the “most frequent activity status” variable (MFAS).⁴ The choice is made to consider the working activity during the whole year prior to the survey as it is more consistent with the poverty assessment which is based on the income received by the household during the whole previous year. Let us notice too that the focus of the European indicator is only on people working effectively (employees and self employed) contrarily to some other international definitions where availability for work and job search are also considered, in the line of the ILO definition of active population.⁵ This indicator is completed by the breakdown of the individual and job characteristics of the working poor as complementary information for interpretation.

Other European indicators related to the issue of working poverty have also been defined. A first one concerns the breakdown of the at-risk-of poverty rate by the work intensity of households⁶ and a second one the rate of persons living in jobless households. The policy status of these different indicators has changed since 2003 and reflects the relative dilution of social issues in the ‘streamlined’ Lisbon Strategy refocused into the ‘Growth and Employment Strategy’. The indicator of working poor as well as the one related to work intensity of the households are now relegated in the ‘secondary’ list, i.e. indicators that support the primary indicators by describing in greater detail the nature of the problem or by describing other

dimensions of the problem, while only the indicator on people living in jobless households is in the restricted list of primary indicators.

Incidence and factors explaining working poverty

Before entering in the description of some results concerning the extent of working poverty in the EU we must mention the problems related to the data sources. Prior to 2002 and for the EU-15 the results were based on the ECHP data for the years 1994 to 2001. This survey has been replaced since 2003 by the EU-SILC survey on income and living conditions which is compulsory and will cover the whole enlarged EU. But both the transition from one survey to another and the enlargement of the EU have generated some problems concerning comparability of the data and breaks in time series. The implementation of the EU-SILC survey has been fully completed for EU-25 countries only in 2007. Meanwhile, the data will be a mix of different sources. Certain countries have already launched the EU-SILC from 2003 (BE, LU, AT, DK, GR, IE, NO) joined since 2004 by the other countries of EU-15 (except NL, DE and UK) and new Member states (excepted EE). Thus fully harmonised and comparable data is not yet available for all countries, and the information is added using national sources harmonised ex post according to Eurostat' principles. These elements have to be kept in mind when considering the above information.

In 2006, 8% of EU-25 workers (16 years and over) were working poor, according to Eurostat estimates. Even though this percentage may seem modest, it represents no less than around 15.5 million European workers living in poor households. In comparison, the rate of poverty among individuals not in employment was at 23%, and at 41% among unemployed persons.

Within EU Member states, the higher rates of working poor are found in Greece and Poland (13 to 14%) and also to a lower extent in Latvia, Portugal, Spain, Italy, Lithuania, and Luxembourg (9 to 11%).

The factors that have to be considered when trying to explain working poverty are mainly the same as those generally used to explain poverty in general. They could be broadly divided into three main complementary fields: individual and job characteristics, household characteristics and institutional countries characteristics. In the continuation we will briefly review these characteristics to highlight their relative contribution to working poverty. The numbers mentioned generally concerns the situation of EU-15 in 2001 as these are unfortunately the last published by Eurostat concerning the characteristics of working poverty.⁷ Individual characteristics such as gender, age or education have been demonstrated to influence the risk of being poor.

Apparently, there seems to be no significant gender differences regarding the incidence of working poverty. The number of male working poor is slightly higher than female working poor. Nevertheless, this conceals the fact that women are significantly more exposed than men when we consider their household (lone parenthood for instance) and employment characteristics (higher exposures to part-time work, low paid work, gender segregation in terms of occupations and wages,

different career patterns...). The distribution of working poor according to their age shows a U-shape influence, working poverty being generally lower for middle age workers. Working poverty is higher for low educated individuals and decreases with the rise of educational attainment (12% for low educated individuals against 3% for highly educated people). Low skilled workers are also typically those occupying low quality jobs.

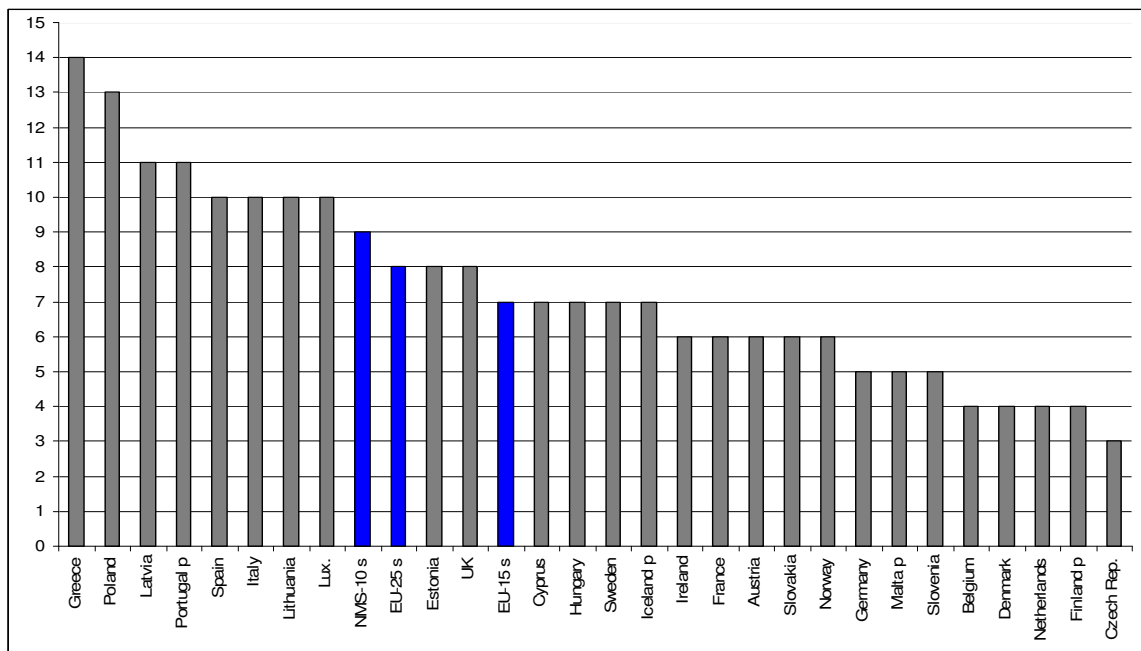


Figure 7: Working poor in the EU-25 (2006)

(s) Eurostat estimate

(p) Provisional value

Source: Eurostat web site.

Individual job characteristics have also a significant impact on the incidence of working poverty. Poverty is nearly twice higher among workers with fixed-term contracts (10% against 4% for those with permanent contracts) or part-time contracts (10% against 5% for full-time workers). The same pattern occurs for workers who have not worked during the entire year prior to the survey (12% against 5% for those who have worked the full year). This highlights clearly the strong link that can be made between the issue of working poverty and the global issue of quality of employment.

We mention also that poverty was much higher for self-employed than for waged employees. It is well known that there is a certain underestimation of income for the self-employed, especially when it is self-assessed as it is the case in the ECHP

and EUSILC, and that part of this higher working poverty rate could be attributed to data quality problems. Nevertheless this could be also related to occupational features for certain countries (high number of self-employed working poor in the agricultural sector for instance). Different studies show that there is a relation between low employability and take-up of self-employment occupations (Le Blansch et alii, 1999). There are also relations with particular labour market issues such as the lack of access of migrants to 'regular' labour markets, as highlighted for instance by Slavnic in the case of Sweden (Slavnic, 2002).

Another relevant characteristic of individual job situation that should be mentioned, despite it is not taken into account in the EU indicators and debate for policy reasons, is the link between low paid work and working poverty. We mention earlier that both issues are sometimes mixed up. If they are linked they are nevertheless distinct. One can be a working poor with a relatively higher wage and conversely a low wage worker is not necessarily a working poor depending on resources provided by other members of his/her household. Nevertheless, working poverty is clearly higher among low wage workers. According to a study, in 1995 some 20% of European low wage workers were also working poor (Marlier and Ponthieux, 2000). But low wage work does not seem to be the most significant contributing factor to the working poverty situation. In many European countries the household composition rather than the low wage work is by far the main reason behind the observed working poverty (Strengmann-Kuhn, 2002).

Thus, household characteristics have to be seen as determinant to explain working poverty. Household' composition, size and labour market attachment of its members affect heavily poverty and working poverty situations. Differences in household characteristics account also to explain observed differences between EU countries. Working poverty is much higher in households with dependent children than in those without children. This is especially true for monoparental and/or jobless households (respectively 19% and 20%). But the more determinant factor is the labour market attachment of the other members of the household. In households without children the working poverty rate is only of 3% in households where other adults are at work members against 9% if the other adults of the household do not work. In presence of dependent children in the household these rates rise respectively to 5% and 20%. If we consider the indicator on the work intensity of the household (see definition above) we observe that in households without dependent children the working poverty rate is at 5% when all adults are fully working against 10% if other adults do not work full-time or full-year and 30% if nobody is working. The difference is much stronger in households with children where these rates are respectively of 5%, 40% and 63%.

Working poverty increases with the size of the household and the number of non working members. This illustrates also that in many European households, especially when there are children, a single wage is generally no longer sufficient to avoid poverty. These factors explain in good part the observed differences between Mediterranean countries (but also Austria and Ireland) and the rest of EU 15 in terms of extent of working poverty as these countries have bigger households size but also more single earner households (Iacovou, 2003). This has also to be related to

patterns of women participation to the labour market and also the importance of families in less encompassing welfare states.

Earnings inequality and in-work poverty. Institutional settings and public policies

The protection of the working poor and low-income workers and the reduction of income inequalities should result from a wise combination of social protection policies, labour market policies and fiscal policies. We know very little as yet about the impact of these sets of policies. We still know less about how different combinations of social, labour and fiscal policies can ameliorate the position of such social groups and which combinations may be wisest. Let us start by trying to spell out what policies we are talking about.⁸

In the realm of social protection policies, each welfare state counts on different institutional designs and settings. Entitlements and actual access to social protection schemes differ among countries and regions and may be based either on individual or household conditions. Outputs are also very varied, even among 'families of welfare states' or types à la Esping-Andersen (1990).

Of the broad array of policies included in any social protection system, those most likely to influence the situation of low-income workers and the working poor are obviously policies devoted to income maintenance within active ages, that is, unemployment protection and minimum income schemes. For the working poor this is even more salient if we take into account that poverty is measured mainly in economic terms.

However, this is not to deny that, the whole system of income maintenance bears relevance. For instance, the protection intensity of sickness allowances, retirement pensions, partial or total invalidity pensions, widows' pensions may become important depending on the composition of households. The same can be said about other policies usually included in the system of social assistance: non contributory or flat-rate universal minimum pensions for the aged and the disabled and top-ups of pensions in order to reach a minimum amount within a certain system constitute some examples. Furthermore, family policies may also be relevant, be it through fiscal exemptions, tax credits, allowances, subsidies for large families, protection of lone parenthood, provision of care for dependants and so on.

The level of development of welfare services may appear as bearing a lesser importance for the protection of low-income workers and the working poor. Nonetheless, the degree of de-commodification of welfare services may well have an impact among those low wage individuals/families that must resort to the market to gain access to welfare services in situations of low de-commodification. One cannot deny the importance of access to the different levels of the educational system in order to foster upward mobility and/or exit from poverty. Access to housing is also relevant. In the health care domain, coverage tends to be universal in all EU-15 countries, but the (partial) absence of some basic health care services from the list of those publicly financed can put a strain on household and individual budgets. An example is whether dental care is covered by the public health care system or not.

Furthermore, the design of co-payments, that is, to what degree they are proportional to income, may well have an impact on household or individual income. One could say something very similar about the provision of social and individual care services.

Going back to those social policies that bear the main burden of income maintenance during active ages, unemployment protection is usually split between unemployment subsidies (contributory) and unemployment assistance. The ability of these policies to protect low income and in-work poverty situations depends on the conditions for access, the level of replacement rates and of the period of time they can be enjoyed. While unemployment subsidies tend to be tied to previous earnings, unemployment assistance consists generally of less generous programmes, which may require involvement in some kind of work or (re)training programme. Protection provided by minimum income schemes is also very important, especially considering that access to them is usually based on household income thresholds. Minimum income schemes are very heterogeneous depending on the country (and sometimes on the region) and so is their generosity and conditions for access, which in many cases also demand some kind of labour insertion. Some countries compensate low generosity of minimum income schemes with intense unemployment protection or vice versa; the problem of under protection for workers with discontinued participation in the labour market is obviously most acute when both policies are poorly developed.

Last but not least, non-wage benefits – in particular the extent to which workers are covered by health insurance and pension plans – represent an important dimension of job quality. The role of non-wage benefits is becoming increasingly important in view of the efforts to control public spending on social security, health and pensions. Thus, disparities in access to complementary schemes, which are often linked to employment, may represent an important new source of disparity in job quality that will require attention from policy makers.

As for labour market policies, the array of them present in most countries is no less broad, complex and heterogeneous than social protection policies. Policies such as minimum wages and wage policies, hiring and firing policies, the structure of collective bargaining, employment promotion schemes, incentives for employers to hire certain disfavoured categories of workers, vocational training, and workforce mobility programmes may have an impact on the situation of low paid workers and the working poor.

Once again, it should be noted that causality links among the design and degree of development of these policies and income inequality and proportion of low paid workers has not been spelt out by research efforts so far. Countries with low expenditure on activation policies, comparatively rigid labour markets and high wage inequality tend to bear the highest proportions of low income workers and working poor, but such conclusions are in need of further research. Interactions with social protection policies have not been studied in depth either. Lack of employment opportunities may, for example, be more important than the amount of the minimum wage in a certain labour market to increase in-work poverty, but this may be compensated by the generosity of the income maintenance system.

Fiscal policies of different kinds have been recently introduced in a number of countries in order to improve the net earnings of low paid workers or the working

poor (Kammerling 2009). These policies include comprehensive reforms of the taxation system, reduced taxation on low wage workers and targeted systems of tax credits. Also, many countries use subsidies for contracting specially disadvantaged social groups and partial or total exemptions on employers' social contributions for first-time hiring and skills training contracts among others. We know very little as yet about the impact of these policies *per se* and even less about how they combine with other social and labour market policies. Furthermore, the conclusions of the meagre existing research are still partial and debatable. In many cases, the situation improves for a certain category of low paid or working poor, while it deteriorates for other categories.

Assessing the impact of national institutional settings on working poverty is not an easy task as there are numerous levels of influence, not only in terms of income but also in terms of wider characteristics such as availability and affordability of social infrastructures and services (child and dependent persons care, health care system, ...), and labour market institutions and tax policies. We build here on a recent study by Lohmann which has tried, using pooled data from the ECHP for the 1994-2001 waves for the EU-15 (except Sweden), to disentangle the effects of these various institutional settings on working poverty (Lohmann, 2006). The results show that working poverty is lower when welfare generosity is high, which could be explained by the poverty reducing effect of transfers or to implicit minimum wages set by the level of replacement rates. The empirical analysis of working poverty characteristics highlight that there is indeed a strong interplay between welfare state characteristics and the composition of households and the labour market involvement of household members (Andress and Lohman, 2008).

However, also differences in the occupational structure, importance of self-employment and the general level of education have a strong influence on the extent of working poverty. The study confirms also that if low wage work is positively correlated with working poverty it contributes only to a rather extent in comparison with the other individual and household characteristics to explain the observed differences among European countries. These differences in characteristics explain to a large extent country differences in EU-15, especially when comparing Spain, Greece, Italy and Ireland against other European countries. When it turns to the impact of labour market institutions the picture is less clear as the results at the macro level are altered strongly depending on which factors are taken into account at the micro level, especially the differences in the composition of households and the labour market attachment of the household members and the extent of self-employment. If these are neutralised, then the risk of working poverty appears to be lower when (centralised) higher-level bargaining is combined with a minimum wage (Lohmann, 2006). However, a recent European Commission report highlights the determinant role of wage bargaining coverage to reduce working poverty. While wage bargaining centralisation, trade union density and coordination do not appear to have any significant effect on working poverty, an increase in wage bargaining coverage by 10% is associated with a reduction of in-work poverty by around 0.5 % (European Commission, 2008). We could tentatively derive from this analysis that it would be of help to resolve in work poverty situations if social, labour market, education and tax

policies were designed by taking into account household composition and characteristics to a greater extent.

Data and indicators

There are two main statistical sources of data on wages and income in the European area. On the one hand, there is a four-yearly source based on information supplied by firms, the *Structure of Earnings Survey* (SES) (the last having been published in 2002), carried out within the EU with common criteria regarding methodology and contents, aiming at obtaining comparable results of the structure and distribution of wages. This survey looks into the distribution of wages depending on a wide range of variables such as sex, occupation, branch, length of service, or the size of the company. On the other hand, a source based on information supplied by households, the *European Statistics on Income Living Conditions* (EU-SILC), available from 2002- 2003 for all the EU countries and whose antecedent was the *European Community Household Panel* (ECHP), carried out during 1994-2001. EU-SILC is the reference source for income and social exclusion statistics, giving information on income and on the most important sociodemographic and labour characteristics of individuals and households.

There is a source on income data with a wider comparative scope: the Luxembourg Income Study (LIS),⁹ currently covering 30 countries of Europe, America, Asia and Oceania and data series from early '80's. It harmonizes and standardizes several databases, coming from the micro-data from the different surveys, in order to facilitate comparative research, the main ones being: 1) the *LIS database*, which includes household income surveys, with data on income, demographic, labour market and expenditure information on three different levels: household, person and child; 2) the *LES database*, including labour force surveys from countries with quite different labour market structures and detailed information on areas like job search, employment characteristics, comparable occupations, investment in education, and migration; 3) and the *LWS database*, that will be available in 2007, providing microdata from 2003 onwards on household wealth.

These three statistical sources in combination provide a thorough outlook on wages and income, on the most relevant characteristics of individuals and households, including its panel design to study changes over time. In any case, research in this field is still encountering some limitations in the availability of appropriate data or indicators.

The most noteworthy of these limitations are the following:

a) Measuring earnings, income and respective differentials is very difficult because of problems with the source of data, the coverage, the definition of 'earnings' (whether it includes social benefits or family allowances) and the fact that earnings tend to be misreported (this is the typical shortcoming of household surveys), as both employers and workers might underreport actual earnings for tax purposes. Employer-based surveys, such as the SES, usually yield different results from those obtained using household surveys, because, wages in the private sector, for example, tend to be more unequally distributed, and the main difference is that

these surveys are based on very different designs, with differences in coverage and sampling procedures. The only way to correct these limitations is by making available, and eventually integrating, administrative sources on wages and other income, such as tax and social security sources, which include the bases for contribution to the social security system and different kinds of social benefits. The recent availability in Spain of a source like the *Continuous Sample of Working Lives* (MCVL in Spanish) can turn out to be a good example on the way to completing survey-based sources.

b) There are still some problems relating to harmonisation and non-comparability in EU-SILC source, but an even more serious issue from a longitudinal perspective is the limited panel length, as only a four-year observation window will be required in order to meet Eurostat's specifications. Other issues associated with longitudinal data have to do with representativeness and coverage, attrition, non-response in surveys, incompleteness of records over time, sample size, accuracy of information. All of them limit researching low pay or income dynamics.

c) Even though SES, as well as EU-SILC, does gather some information on other characteristics of employment, apart from the rewards, most of this type of information is available in other sources, like the *Labour Force Survey* or the *European Working Conditions Survey*. This accounts for the reduced possibility of looking into other objective and subjective indicators of employment quality together with wages.

Future research. Some tentative proposals

To begin with and as signalled in the previous section, efforts in the direction of a better harmonisation, comparability of data and completion/duration of data sets are of the utmost importance in order to allow for the advancement of future research. This is closely linked to the fact that future research should be based on longitudinal rather than snapshot analyses. In terms of low pay, poverty and working poverty dynamics, it is necessary to study how situations evolve in the medium to long term, for labour participation in the short term usually shows a very irregular pattern, thus obscuring tendencies in mobility. Also households should turn the unit of analysis rather than individual situations, for the welfare of people depend primarily on how resources are pooled and distributed within households. The tendency of earnings inequality to grow and the impact of low earnings are more obvious than the tendency of overall household poverty or of the working poor households to increase. Within the scope of the households, apart from the general labour market performance, determined by the dynamics of supply, demand and the regulating institutions, there is also the influence of unequal chances of the households' labour participation depending on their life-cycle and composition. When households are included in the scope of analysis, the tendencies of inequality prove to be more varied and more dependent on labour market institutions and policies as well as social protection. A crucial aspect of future research is to measure the degree in which tendencies of inequality are associated with differences in employment earnings of young men and women as well as with the demography and the structure of their households (Esping-Andersen 2006).

Second, the need to protect both low wage workers and households has reached the centre of debates on social policy reform. On the one hand, increasing flexibilisation of labour markets and the widening of wage disparities have led to the upsurge of new and problematic situations among low wage workers who are facing growing poverty risks. On the other hand, policy-makers are increasingly aiming at ensuring that income guarantee programmes avoid prolonged dependency among beneficiaries and promote labour participation. Therefore, the tailoring of future policies and the reform of present ones is very delicate. We need to know much more about the impact of different sets of public policies and the interrelationships among them if we wish to use policies to ease the exit from both low pay and in work poverty situations at the same time as enhancing labour participation. RECOWE offers a unique opportunity to gain such an objective by putting together specialists in welfare and work, whose fields of research have tended to remain separate for a long time.

Third and last, research on the working poor has been gaining relevance only in the last few years. Such salience is due to the fact that the issue revolves around confluent worries about the evolution of inequalities within the labour market on the one hand, and mounting interest on social inclusion policies based on employment rather than on social transfers on the other. To this, higher availability of statistical sources may be added, thus easing empirical knowledge about working poor situations. Because of these reasons, the issue is susceptible of attractive conceptual and theoretical developments and its analysis may derive valuable conclusions to be applied to the reform of public policies.

The concept of working poor is quite attractive for the design and redesign of social policy, but it also presents high analytical complexity. Working and living in a poor household constitutes one of the main risks around which European social policies revolve at present, but the use of this concept has the risk of labelling in a negative way what is just an operational concept of inequality, and even more of relative inequality. However, its hybrid character, composed by an individual dimension (occupation) and a collective dimension (household income) makes the analysis of working poor profiles very complex. The analysis of its determinants (labour participation, salaries, household composition and social transfers, among the most salient) is equally if not even more complex. Labour participation of households constitutes an especially problematic aspect, for the commonly used measure of such participation, i.e. the time effectively worked by the working age adults of the household, is unable to reflect their unequal employability. The analysis of such employability in terms of the probability to become occupied in function of the characteristics of the members of the household constitutes a new analytical path that is beginning to be explored.

Finally, another learning issued from the study of working poor is the need to shift perspective not only to household level but also to a wider understanding of what to be at work means. The traditional definition of employment status based on the ILO convention (working in previous two weeks) appears insufficient as it may hinder various employment trajectories which are becoming increasingly common. Instead, considering the quantity of work during the previous year highlights the existence of significant number of workers who have been experimenting transiting

spells between different status of employment (full-time/part-time, temporary/fixed/term contracts) and activity (unemployment, inactivity, training) during the last years, with clear repercussions on their personal and household income.

¹ The classification of sectors into skilled and unskilled is based on share of skilled workers into the labour force of the sector, where a person is considered skilled if he or she has at least upper secondary education. IMF (2007, pp. 181-182) classifies 19 sectors of ISIC.

² Most of them in the done in the context of the research projects LOWER and DEPATEM; their main results being available in Lucifora, Bazen and Salverda (2005), Marx and Salverda (2005) and Gregory, Salverda and Schettkat (2007).

³ For a complete review and discussion of the different concepts and definitions of the working poor see Peña-Casas and Latta (2004).

⁴ The MFAS is build using the calendar of activities included in the ECHP and EU-SILC which survey the activity of the household members during the year prior to the survey.

⁵ According to the SGI this is done to avoid confusion between working poor and 'active poor' but it could also be argued that it excludes from the definition not only the unemployed but also some people who are only temporally not at work due to training or paid leave. Using the ECHP data for 1999 the rate of working poor is at 7% for the EU-15 but if active poor are considered it raises to 10% (Peña-Casas and Latta, 2004).

⁶ The work intensity of the household refers to the number of months that all working age household members have been working during the income reference year as a proportion of the total number of months that could theoretically be worked within the household. Individuals are classified into work intensity categories that range from WI=0 (jobless household) to WI=1 (full work intensity).

⁷ We will draw here on results coming from various studies. For detailed presentations and discussion of related results see Peña-Casas and Latta (2004), Lelièvre et al (2004) or Bardone and Guio (2005).

⁸ A tentative analysis of the impact of social, labour market and fiscal policies on the situation of the working poor in EU countries may be found in Peña-Casas and Latta (2004: 61-89).

⁹ <http://www.lisproject.org>

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